RS650-42

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 15A

April 13, 1990

JAPAN AND LATIN AMERICA

Summary

Japan, expected to play a leading role in alleviating the debt crisis in Latin America, has not had particularly broad-based ties with the region. Trade is modest, but imports have risen, shrinking Japan's surplus with the area to about half a billion dollars a year. Japanese foreign direct investment is centered in a few countries, primarily those known as tax havens. The uncertain political climate, both regionally and in individual countries, deters investments, while laws, such as those based on protecting infant industries, restrict trade. Japan is likely to continue to slowly strengthen its ties with Latin America, but the region is likely to find itself vying with Eastern Europe for Japanese investment and trade opportunities.

Overview

Latin America -- Central America, South America and the Caribbean -- has been the traditional backyard sphere of interest of the United States as exemplified by the Monroe Doctrine, which claimed the Americas for Americans. But the former financial paternalism exercised by Washington in the area has been changing as the United States tightens up its aid programs, a reflection of its own fiscal difficulties. The problems facing Latin America -- the debt crisis, drug cartels, civil wars, poverty -- are of such magnitude that the United States appears unable to maintain the dominant leadership role it once had in the region. Washington increasingly is looking to multilateral solutions and in particular a stronger role by Japan.

Japan's links to the region have been weak, with Brazil a notable exception. Japan in the past has concentrated on Southeast Asia, which had cheaper supplies of natural resources and lower labor costs than Latin America, where inflation and political upheavals also have combined in most countries to discourage large investments. Brazil, however, has developed close ties with Japan, starting with fortune-seeking immigrants who arrived at the turn of the century and kept coming until Japan's economic juggernaut took shape. The enclaves of Japanese and their descendants -- now approximately 1.2 million people -- have been relatively prosperous. Given economic differences between the two countries today, however, a reverse migration of Brazilian-Japanese workers has developed, with these immigrants taking on the dirty, difficult and dangerous jobs that the more prosperous Japanese worker shuns today.

As a part of Japan's view of its growing international responsibility as the leading creditor nation, Tokyo is looking to help find a workable solution to the Third World debt crisis. Japan may even look toward Latin American economic recovery as a way to help ease U.S.-Japan trade problems by encouraging stronger markets in the region, which could absorb more exports from the United States.

Foreign Investment

Japan's interest in Southeast Asia is well-known; these close-to-home markets enable low international transportation costs. Japanese direct investment in Latin America, however, actually outpaced the flow of money going into Asia in four of the last five fiscal years. Cumulative Japanese investment in Latin America of $31.6 billion through March 1989 was almost equal to the $32.2 billion total for Asia (see JEI Report No. 31A, August 11, 1989) and topped the $30.2 billion invested in Europe. Japan's $75.1 billion direct investment stake in North America, however, greatly outweighed that in other regions.

Japan's $26.1 billion in nonmanufacturing investments in Latin America is approximately five times the investment in the manufacturing sector (see Table 1). Nonmanufacturing investments are concentrated in banking (40 percent) and in transportation (35 percent). Japan has little invested in other sectors.

The Latin American investment figures are somewhat skewed, however, because of pockets of concentration that have important implications for Latin America. The majority of Japanese money is invested in Panama, which had $12.9 billion in Japanese investment at the end of FY 1988 compared with the $5.6 billion funneled into Brazil (see Table 2). The funds in Panama primarily represent the registration of vessels by Japanese shipping companies; some money also has gone into the banking sector. The Caymans, like many of their Caribbean neighbors, are known for the many tax shelters established there. The Caymans are host to $5.1 billion in investments from Japan, while the Bahamas are home to $2.7 billion.

Aside from these tax havens and Brazil, Japanese businesses generally have been hesitant to invest in Latin America. Rapid or even runaway inflation in many countries lowers profits in yen terms. Problems caused by inflation can

The JEI REPORT (ISSN 0744-6489) is published weekly except for the New Year, Memorial Day, Labor Day, Thanksgiving and Christmas holiday weeks for $40 per year by the Japan Economic Institute of America, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036. Second class postage paid at Washington, D.C. POSTMASTERS: Send address changes to JEI REPORT, 1000 Connecticut Avenue, N.W., Washington, D.C. 20036.

Table 1: Japan's Foreign Direct Investment in Latin America by Industry Through March 1989

(in millions of dollars)

Manufacturing Sector	$5,437
Food Products	223
Textiles	439
Wood and Paper Products	200
Chemicals	590
Metals	1,933
Nonelectric Machinery	378
Electric Machinery	491
Transport Equipment	1,050
Other	132
Nonmanufacturing Sector	26,111
Agriculture and Forestry	190
Fisheries	146
Mining	1,557
Construction	208
Trade and Sales	1,508
Banking, Finance & Insurance	10,990
Services	931
Transportation	9,236
Real Estate	142
Other	1,203
Branch Offices	45
Other Transactions*	23
Total	31,617

*Certain overseas real estate transactions have been excluded from Japan's foreign direct investment data since December 1, 1980.

Source: Ministry of Finance

be compounded when a country has rules limiting the repatriation of profits. Political instability and uncertainties about nationalization of companies further discourage investments.

One major exception is Mexico, which has had some success in recent years in attracting Japanese investment because of the provisions for maquiladora plants along the U.S. border. Mexico exempts factories in maquiladora zones from some of its local-content and export requirements in exchange for investments, while the United States charges duties only on the value added to products assembled at the plants from American-made parts and then reexported to this country (see JEI Report No. 31A, August 11, 1989). Some analysts have predicted that Japanese investment in maquiladora plants will reach $3 billion by 1991. Maquiladora facilities, which can be 100 percent foreign owned, have led the way for further liberalization of foreign investment in Mexico.

Table 2: Japan's Foreign Direct Investment in Latin America, FY 1984-FY 1988

(in millions of dollars)

Country	FY 1984	FY 1985	FY 1986	FY 1987	FY 1988	Total as of March 31, 1989
Panama	$1,671	$1,533	$2,401	$2,305	$1,712	$12,858
Brazil	318	314	270	229	510	5,596
Caymans	1	132	930	1,197	2,609	5,085
Bahamas	97	298	792	734	737	2,718
Mexico	56	101	226	28	87	1,671
Bermuda	29	148	16	36	337	991
Netherlands Antilles	66	62	66	199	172	747
Peru	6	10	--	1	--	696
Latin America*	2,290	2,616	4,737	4,816	6,428	31,617

*Including Caribbean and other regional territories.

Source: Ministry of Finance

In addition to the current, significant investments in mining operations and in steel and nonferrous metals, particularly aluminum, Japanese investment in Latin America is expected to increase in such product groups as consumer electronics and telecommunications equipment. Consumer electronics products primarily would be manufactured in such countries as Argentina for a third-country export market, primarily the United States and Europe. Japanese companies also are interested in the potential telecommunications systems market in Brazil.

Using Japan's technology and engineering know-how some businessmen proposed last summer exploring the possibility of building an interoceanic canal, similar to the aging Panama Canal. The concept of a Nicaraguan canal dates from the last century, but analysts expect little tangible progress will be made on the project. Japanese businesses also are considering the possibility of constructing a land bridge in Colombia to facilitate cargo traffic between the Atlantic and the Pacific.

Trade

Japan's historic trade surplus with Latin America has been shrinking steadily since reaching $3.3 billion in 1986 (see Table 3). Last year the gap between exports and imports totaled just over half a billion dollars. However, the country continues to run a big deficit in trade with South America totaling $3 billion in 1989, reflecting Japan's demand for agricultural and industrial inputs and energy-intensive products and perhaps indicating import restrictions in some South American countries.

For example, several South American countries are major suppliers of nonferrous metals to Japan, including Chile ($446 million in 1989 or one-third of its Japan-bound sales), Venezuela ($400 million, a full three-fourths of

Table 3: Japan's Trade with Latin America, 1985-89

(in millions of dollars)

Country	1985		1986		1987		1988		1989	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Central America	$4,580.1	$2,146.5	$4,499.5	$1,771.7	$4,141.7	$1,857.9	$4,710.4	$1,917.2	$4,745.5	$2,034.0
Belize	3.3	0.9	1.9	0.4	5.4	0.4	19.7	0.9	10.8	8.4
Costa Rica	85.2	6.7	99.5	13.7	104.6	14.6	60.4	18.6	94.0	22.3
El Salvador	43.2	39.4	33.0	33.9	59.3	29.1	41.2	29.5	42.0	17.5
Guatemala	51.0	39.7	45.4	57.8	78.1	27.3	72.6	34.2	76.7	45.6
Honduras	46.7	48.9	70.3	100.1	64.9	63.1	71.3	63.5	76.6	104.1
Mexico	994.0	1,869.9	1,032.0	1,439.0	1,388.9	1,625.2	1,772.3	1,590.7	1,907.7	1,729.9
Nicaragua	23.3	59.5	9.5	42.2	13.8	29.2	13.4	43.0	17.3	21.2
Panama	3,326.1	81.3	3,196.8	83.7	2,416.4	68.4	2,652.6	136.5	2,512.1	84.9
Canal Zone	7.3	0.2	11.1	0.1	10.3	0.1	6.9	0.0	8.3	0.1
South America	2,219.9	3,786.9	3,181.7	3,997.8	3,182.5	4,018.1	3,161.5	5,856.0	3,216.7	6,251.9
Argentina	225.4	443.0	361.0	503.3	443.4	299.6	298.2	495.0	176.3	416.9
Bolivia	46.7	9.3	28.7	8.8	47.5	9.3	26.3	18.3	37.6	16.4
Brazil	614.9	1,840.2	973.1	1,874.6	878.8	2,032.4	998.1	2,950.4	1,310.2	2,999.3
Chile	168.6	533.7	294.4	534.6	352.9	616.7	367.6	1,022.5	635.9	1,322.1
Colombia	422.1	150.4	385.9	267.1	388.2	220.7	526.7	296.2	489.4	288.6
Ecuador	173.6	48.0	271.1	77.7	216.8	70.8	115.8	85.3	113.9	106.0
French Guyana	7.7	5.6	10.5	5.5	5.3	7.5	6.4	6.0	6.5	2.4
Guyana	6.8	13.2	17.3	11.5	8.7	8.6	11.1	7.2	9.6	10.1
Paraguay	34.9	8.6	60.6	6.2	77.7	21.8	96.0	51.5	98.4	18.1
Peru	140.6	331.9	224.3	326.0	217.0	326.1	118.3	413.0	77.6	495.0
Surinam	9.7	9.5	8.4	28.2	5.3	27.4	9.2	22.3	10.6	17.7
Uruguay	16.8	25.8	30.4	19.0	35.6	21.8	33.4	25.9	39.4	24.9
Venezuela	352.1	367.7	516.0	335.3	505.3	355.4	554.4	462.4	211.3	534.4
Other Countries*	1,685.8	308.8	1,813.3	424.1	1,436.2	479.4	1,424.8	539.7	1,418.6	584.7
Total	8,485.8	6,242.2	9,494.5	6,193.6	8,760.4	6,355.4	9,296.7	8,312.9	9,380.8	8,870.6

*Including Caribbean and other regional territories.

Source: Japan Tariff Association

Japanese imports from that country), Brazil ($352 million) and Peru ($226 million). Chile and Peru also are important sources of nonferrous scrap. Japan's $3 billion in purchases from Brazil last year were more diversified but were topped by iron ore ($787 million) and steel ($631 million). The composition of imports from Mexico, with which Japan had a trade deficit until 1988, is similarly skewed toward intermediate products, notably oil. The $959 million in Mexican crude bought in 1989 represented 4.5 percent of Japan's supplies.

Japan's exports to Latin America consist primarily of machinery and transportation equipment, but this product slant largely reflects the fact that shipping lines send their vessels to Panama for registration. More typical is the mix of products bought by Mexico and Brazil, the top two Latin American markets for Japanese exporters. Among the $1.9 billion in goods Mexico purchased in 1989 were steel ($123 million), fabricated metal products ($63 million), nonelectric power-generating equipment ($78 million), computer equipment ($56 million), semiconductors and electronic tubes ($176 million) and videocassette and audio recorders ($51 million). The $1.3 billion in products exported to Brazil last year was made up in part of computer equipment ($40 million), electric power-generating equipment ($36 million), semiconductors and electronic tubes ($134 million), scientific equipment ($43 million), watches and clocks ($39 million) and videocassette and audio recorders ($62 million).

Foreign Aid

The United States has been critical of Japan for not taking more initiative worldwide in leadership and burdensharing roles. Foreign aid has been one issue on which recent prime ministers have staked Japan's reputation. Former Prime Minister Noboru Takeshita announced at the June 1988 economic summit meeting of the seven leading industrial democracies that Tokyo would begin a fourth aid-doubling plan to disburse $50 billion from 1988 to 1992 (see JEI Report No. 41A, October 27, 1989).

For Latin America the increase in Japanese spending has meant more aid in dollar terms but a shrinking share of the pie. Official development assistance to Latin America rose from $229 million or 9.4 percent of the total in 1984 to $399 million or 6.2 percent in 1988, although this was a slight drop in dollar terms from the $418 million given in 1987 (see Table 4). (Figures for 1989 will not be released until later this year.) In contrast to Latin America, aid to Africa rose from $221 million or 8.7 percent in 1984 to $884 million or 13.4 percent four years later. This increase reflects Japan's policy of giving a larger share of its aid money to the world's poorest countries rather than to middle-income developing nations, which is the rating given many countries in Latin America by the Organization for Economic Cooperation and Development.

The top recipient in Latin America in 1987 -- the most recent year for which comparative data are available -- was 15th-ranked Brazil, which received 0.9 percent of Japan's foreign aid. Mexico was in the number 17 slot with 0.8 percent of the total. Bolivia, Paraguay, Peru and Honduras rounded out the positions from 21 to 25. In contrast, the United States had three Central American countries as top-10 recipients -- El Salvador in third, Honduras as number seven and Costa Rica at 10. In Washington's second tier of 10 Latin America took half of the positions. Mexico and the Dominican Republic ranked in the bottom of the top-25 recipients. Despite Washington's strong interest in Latin America only Martinique at number 19 and El Salvador in the 20th position

Table 4: Japan's Official Development Assistance to Latin America, 1984-88

(in millions of dollars)

Country	1984	1985	1986	1987	1988
Central America	$50.6	$42.3	$128.5	$86.6	$104.7
Belize	--	0.0	0.3	0.0	0.1
Costa Rica	0.9	0.6	2.8	4.8	6.3
El Salvador	-0.8	-3.5	-0.1	3.4	2.1
Guatemala	1.5	1.3	2.6	2.5	4.4
Honduras	13.7	18.9	36.2	35.0	48.1
Mexico	30.6	19.5	80.8	35.0	38.8
Nicaragua	0.1	0.1	0.2	0.3	0.4
Panama	4.6	4.1	5.7	5.6	4.5
South America	154.9	140.6	159.8	298.1	245.5
Argentina	8.7	8.4	16.2	20.2	26.0
Bolivia	29.6	22.6	23.8	53.8	35.3
Brazil	35.6	40.6	32.3	82.1	66.4
Chile	1.7	6.7	5.4	9.7	15.0
Colombia	24.6	13.9	7.2	4.5	6.7
Ecuador	2.0	1.9	2.9	46.1	16.1
Guyana	2.2	3.4	3.1	0.8	2.0
Paraguay	23.0	18.9	34.0	39.3	43.6
Peru	24.9	21.5	32.3	37.6	28.4
Surinam	-0.1	-0.1	-0.4	-0.1	-0.4
Uruguay	1.8	1.7	1.5	2.1	3.2
Venezuela	0.9	1.1	1.5	2.0	3.2
Other Countries*	23.5	42.1	28.7	33.3	49.1
Total	229.0	225.0	317.0	418.0	399.3

*Including Caribbean and other regional territories.

Source: Ministry of Foreign Affairs

ranked among the top-25 recipients of the OECD's Development Assistance Committee.

Honduras and Mexico are by far the largest recipients of Japanese aid in Central America. Their respective totals in 1988 of $48.1 million and $38.8 million far outpaced the figures for the third-largest recipient, Costa Rica, which received only $6.3 million that year. In South America the top destination for Japanese assistance in 1988 was Brazil with $66.4 million, followed by Paraguay with $43.6 million and Bolivia with $35.3 million.

Augmenting government efforts in foreign aid and debt recycling are private-sector initiatives. Japan International Development Organization Ltd., a group established in 1989 and run by Keidanren (Japan Federation of Economic Organizations) tries to involve businesses in Third World economic development. JAIDO projects help countries earn foreign exchange through a multistep process. The first is the export of agricultural and industrial inputs, for

example, fish. The second stage uses earlier profits to develop a value-added product or industry, such as building a fish processing plant.

In Mexico JAIDO has helped the Ritz Carlton hotel chain in a Cancun project to generate foreign currency through tourism. Other Latin American proposals under consideration include an ammonia fertilizer plant and a fish-processing operation in Argentina and a three-way trade to sell Venezuelan electricity to Trinidad and Tobago, which in turn would sell oil to Japan. JAIDO typically takes a 10 to 15 percent equity stake in projects; other money comes from Japanese companies, local firms and international partners. The average project size is approximately $33 million.

Debt Recycling

The debt crisis more than any other single issue has dominated the economic landscape of Latin America in recent years, officially beginning in 1982 when Mexico announced that it did not have adequate foreign exchange reserves to service its debt. As U.S. funds for bilateral foreign aid programs and multilateral institutions have become tighter and as American commercial banks slowly begin to write off losses on loans to Latin America, many eyes have been looking toward the capital-rich nation of Japan for leadership in debt recycling. Recent elections, including that of Brazilian President Fernando Collor de Mello, may put new economic muscle into previously weak fiscal policies that had failed to win international support -- and breathing room from multilateral lending agencies.

The Brady Plan, a debt-reduction concept authored by Treasury Secretary Nicholas Brady and remarkably similar to an earlier plan by former Japanese Finance Minister Kiichi Miyazawa, is the newest debt-relief idea for Latin America. The Miyazawa Plan was proposed in June 1988 at the Toronto economic summit but was received coolly by both the United States and West Germany (see JEI Report No. 38B, October 7, 1988). Mr. Brady implied that the Japanese plan was a variant of the Baker Plan, named after former Treasury Secretary James Baker (see JEI Report No. 29A, July 31, 1987). Mr. Baker's plan emphasized economic growth as the means to help developing nations repay debts. The concept included new lending to stimulate growth in conjunction with economic adjustment measures; that was in contrast with most other debt relief programs, which are conditioned on austerity.

Mr. Miyazawa's plan differed from Mr. Baker's by calling for a larger role to be played by international lenders like the International Monetary Fund. The IMF would have to sign off on the midterm economic plans of debtor countries and along with banks would have provided additional financing or loan rescheduling. Also, a portion of existing loans would have been converted into bonds at face value. The plan was criticized because many officials worried that foreign governments might be forced to fund a bailout by borrowers.

The Brady Plan, put forth in mid-March 1989, gained international support during the IMF interim committee meeting at the beginning of April 1989. Mr. Brady proposed reductions in the loan principal and interest charges as alternatives for reducing the debt burdens of Third World countries. Tokyo strongly backed the Brady Plan and announced that its Export-Import Bank would channel $4.5 billion to developing nations for debt relief over the next three years. While American banks hold the largest portion of Third World debt, Japan's Ex-Im Bank is expected to play a major role in alleviating the debts of lesser developed countries.

The Brady Plan's first customer was Mexico City, but the eventual agreement did not result in as much debt reduction as Mexico had hoped to achieve. Japanese institutions are the second-largest creditors after their American counterparts of the nearly $50 billion in outstanding public Mexican debt (see JEI Report No. 6B, February 9, 1990). A formal agreement signed in early February 1990 involves a complicated mix of new lending and debt-reduction bonds; it was particularly significant in that it forced Japanese banks to realize losses on a large portion of their Mexican loans.

Debt-reduction schemes in some Latin American countries have been slowed or halted due to changing administrations. Immediately after taking office March 15, Brazil's new president imposed stringent requirements aimed, among other goals, at checking rampant inflation, which during the first two months of this year soared more than 170 percent. Other reforms targeted a 10 percent reduction of the public-sector deficit. In the meantime, creditors of Brazil's nearly $115 billion in foreign debt wait to see how commercial banks and multilateral lenders react to Mr. Collor's plans. Japanese banks, estimated to hold between one-fifth and one-quarter of Brazil's external debt, have been asked by an international group of creditor banks to help develop a program to keep funds flowing to support Brazil's economy.

A key question facing Brazil is to what extent it should deregulate imports and inward foreign investment. Some analysts predict that if Latin American markets do not open further, investment dollars from Japan and other countries may go to the swiftly changing economies of Eastern Europe. Washington is pushing Tokyo to commit financial resources to both regions. But Japan is learning to tie its purse strings to political remuneration.

Politics

The early March summit with Prime Minister Toshiki Kaifu gave President Bush the opportunity to press Japan for a financial commitment to Latin America, particularly to help support the newly elected democracies of Panama and Nicaragua. Tokyo already was committed to helping Managua politically and financially through a United Nations contribution that included $500,000 for diplomatic observers to judge the fairness of the Nicaraguan elections. And Mr. Kaifu said Japan would look further toward providing reconstruction funds to the region in line with the area's moves toward peace. Since both Central American countries face dire economic straits, financial help is considered critical to the success of their democracies. In remarks following Mr. Kaifu's visit, President Bush said he felt Tokyo's assistance in Central America ". . . is very important. And, frankly, I think that will help the U.S.-Japan relationship."

In other ways, too, Japan is making its political presence known. For instance, former Prime Minister Takeshita represented Japan at the swearing-in ceremony for Mr. Collor, who earlier had visited Japan as part of a preinauguration tour to centers of world influence. Moreover, Tokyo has channeled some of its political leadership efforts in Latin America through international financial organizations, including the IMF, the World Bank's Multilateral Investment Guarantee Agency and the Inter-American Development Bank. While developed countries are willing to welcome Japan's additional financing through these organizations on top of Tokyo's bilateral foreign aid programs, they seem reluctant to yield the associated political clout in the region.

Conclusion

Tokyo's support to help solve Third World debt problems is vital. While the United States seems uncomfortable with the concept of powersharing -- particularly in its own backyard -- it needs the help of the world's largest creditor nation, Japan. The two nations are certain to continue to take the lead in working on an international solution, but national egos are sure to be hindrances. This has been most obvious in the case of Tokyo's request to leapfrog to the number-two quota and clout position in the IMF. On the corporate level Japanese businessmen are likely to retain stable but cautious ties with the region as they carefully consider rapid rises in investment and trade and weigh them against various countries' prospects for economic stability and growth.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.